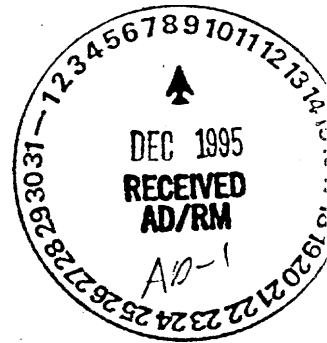




United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

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Memorandum

To: Associate Director, Royalty Management Program
Associate Director, Policy and Management Improvement

From: Carolita Kallaur *Carolita Kallaur*
Deputy Director, Minerals Management Service

Subject: Coalbed Methane Valuation and Reporting Guidelines

On November 2, 1995, the Royalty Policy Board (Board) met at the Minerals Management (MMS) Offices in Lakewood, Colorado. The purpose of the meeting was to review a request from producers of coalbed methane that the costs of removing CO₂ and certain other costs be considered either as a transportation allowance or as extraordinary processing costs deductible against the value of methane.

The Board reviewed considerable written materials submitted on behalf of the industry, the Southern Ute Indian Tribe, the State of New Mexico Audit Office and MMS. At the November 2 meeting, representatives of each of these interested parties met individually with the Board to explain their position.

The purpose of this memorandum is to provide guidance regarding the valuation of coalbed methane production. Of course, the facts of each situation must be considered when applying this guidance with modifications made accordingly. This memorandum is not subject to administrative appeal pursuant to the provisions of 30 CFR Part 290.

Valuation:

Coalbed methane and associated products are valued according to 30 CFR 206.152. The value is the gross proceeds accruing to the lessee under an arm's-length transaction for the sale of the gas after costs of placing the gas in marketable condition. In the case of a non-arm's-length contract, value is determined under the valuation benchmarks at 30 CFR 206.152(c). The value for royalty purposes also includes applicable allowances.

Allowable Deductions:

A transportation allowance is granted for the reasonable, actual necessary costs of transporting the coalbed methane from the royalty measurement point (either the well or the Central

Delivery Point (CDP)) to the point of sale remote from the lease. The transportation allowance allocated to the methane should be calculated according to 30 CFR 206.156 and 206.157. It may include the costs of transporting the methane and the portion of the CO₂ permitted in the pipeline specifications. For example, if the pipeline specifications allowed 3 percent CO₂, the lessee will be allowed to include in the transportation allowance the costs of transporting 3 percent of the CO₂ volume against the value of the methane. Of course, if any of the CO₂ removed from the gas stream is sold at a point remote from the lease, a transportation allowance would be granted for that volume.

Included in the transportation allowance for the methane are the costs of dehydration occurring after metering at the CDP. Any dehydration occurring at the wellhead is not an allowable deduction.

Compression costs incurred to enhance production are not allowable. To the extent the producer can demonstrate that all or a portion of the compression occurring at the CDP is necessary for transportation, that portion will be allowable as part of transportation.

In determining the transportation allowance for both arm's-length and non-arm's-length situations, the lessee has the burden to demonstrate what portion of the costs are attributable to transportation. However, for coalbed methane producers who pay an aggregate sum under an arm's-length contract for both transportation and CO₂ removal, MMS recognizes that in some cases the producers will be unable to obtain the appropriate information to segregate the transportation costs. Thus, MMS will work with the lessees to determine a fair method to break down the bundled costs into the appropriate percentages between costs of transportation and costs of extracting the CO₂. To remedy this situation, MMS plans to perform a study (subject to budget constraints) on processing plants throughout the United States to determine a reasonable allocation of costs and obtain other information.

The costs of extracting the CO₂ cannot be included as part of a transportation allowance.

Processing Allowances/Extraordinary Processing Allowances:

Based on the regulations at 30 CFR 206.158(d)(1), when gas is processed for the removal of acid gases, commonly referred to as sweetening, no processing cost deduction is allowed for such costs unless the acid gases removed are further processed into a gas plant product.

Unless the CO₂ is marketed and sold, no processing allowance may be claimed for extracting the CO₂ from the methane. To the extent the CO₂ is marketed and sold at a later date, the costs associated with CO₂ extraction may be claimed as a processing allowance against the value of CO₂. Included in such a processing allowance will be the costs incurred to "re-dehydrate" the methane as a result of the amine process.

From the data the coalbed methane producers submitted to MMS, it does not appear that this case warrants an extraordinary processing allowance and the amine process is not

extraordinary when compared to the kinds of processing in the overall industry. Therefore, under 30 CFR 206.158(d)(2)(i), the costs of extracting the CO₂ from the methane generally would not appear to qualify for an extraordinary processing allowance and also should not be included in the transportation allowance allocated to the methane.

Other Non-allowable Deductions:

Gathering from the wellhead to the CDP when the Bureau of Land Management (BLM) has approved the CDP as the point of royalty settlement is not an allowable deduction.

Wellhead separation costs are not an allowable deduction from the value of the methane.

Reporting:

The Valuation and Standards Division and the Compliance Verification Division will develop and issue appropriate production and royalty reporting instructions that are consistent with this guidance.

General:

This guidance applies to coalbed methane production under both arm's-length and non-arm's-length agreements. The purpose of this memorandum is to give guidance to the coalbed methane producers specifically in the San Juan Basin area, as well as auditors and other MMS personnel. As noted above, upon the request of any lessee, MMS should consider the relevant facts and use this guidance to make a determination under the applicable regulations.